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**GRID WEST:
A REVIEW OF THE PROPOSED
GOVERNANCE STRUCTURE**

DRAFT PANEL REPORT
FOR REVIEW AND COMMENT

PANEL

Thomas H. Stanton, *Chair**

Alan L. Dean*

Matthew Holden*

Daniel Guttman*

Whitfield A. Russell

* *Academy Fellow*

Officers of the Academy

Carl W. Stenberg, III, *Chair of the Board*
Valerie A. Lemmie, *Vice Chair*
C. Morgan Kinghorn, *President*
Jonathan D. Breul, *Secretary*
Howard M. Messner, *Treasurer*

Project Staff

J. William Gadsby, *Responsible Academy Officer*
Thomas H. Stanton, *Project Director*
Kenneth F. Ryder, *Senior Advisor*
Christine A. Mooney, *Research Associate*

The views expressed in this report are those of the Panel. They do not necessarily reflect the views of the Academy as an institution.

National Academy of Public Administration
1100 New York Avenue, N.W.
Suite 1090 East
Washington, DC 20005
www.napawash.org

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PREFACE

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CHAPTER 1: INTRODUCTION AND OVERVIEW

Recent well publicized problems with elements of the nation's electric power system—most notably the August 2003 blackout in the mid Atlantic and New England areas and the 2001 problems in California—have raised public concerns about the reliability, security, and effectiveness of that system. Continued increases in demand for electric power and the limited investment in expanded transmission capacity in recent years have put additional stress on the systems supplying power to U.S. households, industry, commercial establishments, government buildings and other end users. In response to these concerns, several regions throughout the country have been moving to consolidate and integrate their electric transmission grids within their areas to improve aggregate transmission system efficiency and reliability. Many have also begun to develop independent organizations to operate and monitor these integrated electric transmission grids.

THE NORTHWEST'S CURRENT RTO PROPOSAL—GRID WEST

Grid West is proposed to be a Washington non-profit membership corporation¹ created for the purpose of serving as an independent transmission entity for improving the efficiency and reliability of the Northwest region's electric power transmission system and related markets and centralizing procedures and decision-making on a number of transmission-related issues. The entity would endeavor to capture efficiencies through a variety of methods, which could include creating markets in ancillary services, redispatch, imbalance energy, and related services, adopting common business practices, providing for one-stop internet shopping for transmission services, planning system transmission expansion from a system-wide perspective, performing transmission expansion in certain situations, and consolidating existing control areas under the management of Grid West at the request of utilities wishing to consolidate, all in a manner that reduces the cost and improves the reliability of delivered power to Northwest consumers.

As an independent entity operating the electric transmission grid within the Northwest region, Grid West is intended to:

1. improve the reliability of the regional transmission grid,
2. increase the efficient use of the current grid,
3. offer nondiscriminatory access to transmission services and related markets,
4. provide cost-effective regional transmission planning and expansion,
5. offer alternatives for managing congestion effectively,

¹ Whether tax-exempt status can be sought for Grid West is still being explored. Grid West might seek 501(c)(3) status as a charitable entity on the basis that it "lessens the burden of government."

6. support and establish effective monitoring and mitigation of market power abuses and market manipulation within the Northwest region, and,
7. support effective, independent monitoring of markets, transmission and other related services within its footprint in the Western Interconnection

In carrying out these purposes, the corporation would need to ensure that its policies are cost effective, respond to regional interests, and accommodate environmental stewardship issues. The corporation would also be precluded from owning any transmission or distribution facilities, any interest in generation facilities or output, or operating or having any financial interest in a power or energy exchange.

For a variety of reasons, Grid West would be structured to be an “independent” entity, such that its Board members are expected to act on behalf of the interests of the corporation and the region, not on behalf of individual transmission owners or market participants. While elected by a selection committee of stakeholders, Board members are precluded from having an interest in a market participant. Thus, no Board member could directly or indirectly hold a financial interest in any entity that owns, operates, buys, sells, or brokers power- or transmission-related services. Further, Board members cannot freely leave the employment of a market participant and serve on the Board, and conversely leave the Board to become employed by a market participant.² Among the utilities considering joining Grid West are British Columbia Transmission Company, Bonneville Power Administration (BPA), PacifiCorp, Idaho Power Company, Avista, Puget Sound Energy, Portland General Electric, Northwestern Energy, Sierra Pacific, Nevada Power Company, Alberta Electric System Operator, and various other transmission-owning utilities in the Northwest region, including possibly publicly-owned utilities. Thus, the entity may include Federal agencies, Canadian crown corporations, publicly owned utilities, and investor-owned utilities. Moreover, the area served by Grid West potentially could be much larger than the states of the Northwest region.³

There is concern among some stakeholders that an independent entity will be less accountable to the region than the utilities currently operating transmission systems. By creating an independent entity governed by a board insulated from stakeholders, some regional stakeholders believe existing political and other mechanisms for ensuring regional accountability may be lost, and that Grid West will not act in the best interests of regional stakeholders. There is also some concern that Grid West will not perform its functions efficiently. This concern arises in part because of fears that an independent Grid West may have or develop separate interests from

² The Operational Bylaws do provide exceptions so that a Board member may own diversified mutual funds holding industry stocks, if the fund is not concentrated on the electric industry, and may receive certain retirement benefits from a stakeholder.

³ If all prospective entities were to join, the geographic area (“footprint”) covered by Grid West would include the provinces of Alberta and British Columbia and the states of Idaho, Montana, Nevada, Oregon, Utah, Washington, and Wyoming that are electrically within the Western Interconnection, together with any additional geographic territory within the state of California that is encompassed by the control areas of the Bonneville Power Administration, PacifiCorp, and Sierra Pacific Power Company.

those of regional stakeholders and in part is based on the experience of other similar transmission entities that have seen their operating costs burgeon.⁴ Further, because Grid West will engage in business activities regulated by the Federal Energy Regulatory Commission (FERC), there is an additional concern that FERC will drive Grid West policy according to FERC-driven national goals, rather than addressing regional transmission concerns and issues. Finally, there are countervailing concerns among other stakeholders that Grid West will not effectively address some of the problems encountered in the current regional power system unless it can fully evolve beyond its initial “beginning state.”

GOVERNANCE AND STRUCTURE ISSUES

Because of these concerns and the strongly held and disparate views about the merits of any Regional Transmission Organization (RTO) structure among the various Northwest region electric market stakeholders, the current Grid West proposal contains a complex array of checks and balances with a phased evolutionary structure that reflects a series of compromises among the stakeholders at this point. This complexity with its various limitations and constraints is unique compared to RTOs in other parts of the country and has, in turn, raised some fundamental governance feasibility and workability issues that need to be addressed. In considering whether to support further development of Grid West, BPA has contracted with the National Academy of Public Administration (Academy) to assess the following major issues:

- *Has Grid West created a governance structure that is likely to achieve its desired objective of regional accountability? How well have the bylaws balanced board independence from market participants, regional accountability, and FERC jurisdiction?*
- *Has Grid West created an organization that is workable? That is, as a practical matter, taking the proposal as a given, will the various limitations, process requirements, and constraints on policy formulation designed to create regional accountability make it unduly difficult for Grid West to succeed as an organization—i.e., to perform its functions at reasonable cost and respond to changing circumstances while remaining accountable to the region?*
- *Has Grid West included sufficient safeguards and incentives that enable it to perform its functions efficiently—that is, keeping its costs reasonably low in light of its mission? Are there other ways to help assure that Grid West will be sensitive to stakeholder concerns that Grid West contain its costs, operate efficiently, improve operations, make timely decisions, and evolve as conditions warrant?*
- *What other strengths and weaknesses exist in the currently proposed Grid West governance structure? What changes or modifications to the current structure could reduce those weaknesses or enhance those strengths?*

⁴ Based on annual financial report data, annual operating costs from 2001 to 2003 have increased an average of 16.9% for the NY ISO, 32.2% for the New England RTO, 47% for the RTO in Texas (Ercot), and 50.4% for the Mid-Atlantic RTO (PJM). Some of these increases, especially for PJM, may reflect expansion in both their coverage area and the types of services being provided.

STUDY APPROACH

The National Academy of Public Administration

The Academy is an independent, nonprofit organization chartered by Congress to identify emerging issues of governance and to help federal, state, and local governments improve their performance. It exists to help organizations to achieve excellence in the provision of public services. The Foundation is the operating arm of the Academy for conducting studies and analyses.

The unique source of the Academy's expertise is its membership, which includes more than 500 current and former Cabinet officers, members of Congress, governors, mayors, legislators, jurists, business executives, public managers, and scholars who are elected as Fellows because of their distinguished contribution to the field of public administration through scholarship, civic participation, or government service. Participation in the Academy's work is a requisite of membership, and the Fellows offer their experience and knowledge largely on a voluntary basis.

The Academy maintains a core professional staff that is regularly augmented by study teams recruited for their superior qualifications to contribute to specific projects. Panels composed of Fellows and invited experts from science, business, labor, and other relevant fields direct project and study activities. An elected Board of Directors guides the business and leadership functions of the Academy. The President of the Academy is appointed by the Board to direct operations.

Since its establishment in 1967, the Academy has responded to a multitude of requests for assistance from various agencies and has undertaken numerous studies on issues of particular interest to Congress. In addition, the Academy has conducted projects for private foundations, states and other governments and has begun to develop some private sector partnerships.

Research Methodology

For its study of the Grid West governance structure, the Academy appointed a five member Project Panel, comprised of Academy Fellows and one outside expert, with knowledge of non-profit governance, organization, management, and the electric power industry, particularly in the Northwest region. The Project Panel will meet three times during the study to review the proposed governance structure, bylaws and other relevant documents, decide on related work that needs to be performed, carry out and review the results of that work, and develop a draft and final report on Grid West.

Project staff have supported these Panel reviews by conducting interviews with key stakeholders in the Northwest region electric power industry, officials in Washington, DC familiar with the underlying issues, and other subject-matter experts. Project staff also reviewed background papers and reports prepared by stakeholders involved in the development of Grid West and its predecessor organizations, as well as the current bylaws and other papers defining and describing the proposed Grid West governance structure. These staff analyses, as well as key source documents, were presented and reviewed by the Panel at its first meeting, in August. The staff

then prepared an initial staff draft that was circulated for review and comment to stakeholders and other interested parties in late August. At their September meeting, the Panel reviewed stakeholder comments, revised the initial staff draft report, and developed preliminary findings and recommendations to include in a draft Panel report. This draft Panel report was subsequently circulated to Northwest stakeholders for their review and comments.

THE PURPOSE OF THIS REPORT

BPA has asked the Academy to prepare a Panel report that assesses the Grid West proposed governance structure as formulated in the draft of the Operational Bylaws posted on July 7, 2004. The Panel has not been asked to make judgments or recommendations about the need for Grid West, the policy of assuring independence of Grid West from stakeholder influence, or the appropriateness of any of the particular functions Grid West is proposed to perform. These issues have already been addressed in the Grid West proposal. Rather, the Panel has been tasked with reviewing and assessing the characteristics of the proposed governance structure within the context of the Grid West proposal.

The purpose of this draft report is to invite comments from all parties. The Panel then will review comments on this draft report and issue a final draft report, including final Panel recommendations. The report's findings and recommendations are expected to be presented to a meeting of the Regional Representatives Group (RRG) on October 12. The Panel will submit the final draft written report by October 26.

ROAD MAP TO THE REPORT

Chapter 2 reviews the unique aspects of the electric power industry in the Northwest region and the perspectives held by different stakeholders in that system. The chapter also reviews—but does not draw conclusions concerning--the rationale for an organization to operate an integrated electric transmission grid, assesses its applicability to the Northwest region and describes stakeholder concerns about expected benefits, costs and other risks, including an increased FERC regulatory presence.

Chapter 3 describes the current proposed Grid West governance structure, including the rationale for the various restraints and limitations on the Grid West Board operations included in the bylaws.

Chapter 4 assesses the current proposed governance structure using explicit critical elements that the Panel believes are essential to achieve a sound and sustainable governance structure. This chapter also evaluates possible alternatives for achieving the intended stakeholder objectives. Specific Panel recommendations and the supporting rationales are also presented.

CHAPTER 2: THE NORTHWEST CONTEXT

The proposed governance structure for Grid West reflects a detailed set of compromises achieved by the various Northwest electric power stakeholders that have participated, often over several years, in the debate surrounding Grid West and its predecessor organizations—RTO West and IndeGO (Independent Grid Operator)—that had been proposed for the region. This chapter examines various stakeholder views about what changes may be needed in the Northwest power industry and the role of FERC and other regulatory bodies in promoting and overseeing any change. Since these concerns reflect the stakeholders' current positions in the electricity market and expectations about changes in those positions, the historic role of electric power in the Northwest region and the unique aspects of its electric power industry must also be understood.

UNIQUE ASPECTS OF ELECTRIC POWER IN THE NORTHWEST REGION

To most economists, regional electric power systems share many common characteristics. At the most basic level, power generators (suppliers) must have access through a transmission network or grid to provide the electricity that end users—consumers and industries—demand. All regional markets are affected by both transmission and generation capacity constraints, although the severity of those constraints varies by region, system topology, contractual obligations among parties, and temporal factors (e.g. season, day of the week, time of day). Likewise, the economic costs of supplying electricity and the costs to consumers will vary depending upon the type of generation, the geographical dispersion of consumers relative to suppliers, the variability of demand (seasonal, peak load differences), the extent of market power exercised by individual participants, and the age, condition and size of the existing transmission grid. Virtually all Northwest region stakeholders have noted that FERC regulatory policies and market reforms have relied on a market-based economic approach to regional electric power systems when fulfilling obligations under the Federal Power Act and have at times failed to be sensitive to the unique aspects of the electric power system in the Northwest region.

Two elements dominate the Northwest power system— the role of hydropower and the federal government, more specifically BPA, which is responsible for selling the electric power obtained from the Federal Columbia River Power System. These two elements have helped this region's consumers and industries enjoy relatively low cost and reliable electric power for over half a century⁵. The region has often exported its seasonal excess energy to other markets.

As a federal power marketing agency, BPA relies primarily on Treasury borrowing authority to finance its capital spending needs and thus has lower funding costs than its private sector counterparts. Moreover, as a federal entity, BPA provides two additional advantages to its Northwest power customers—it is only minimally subject to FERC regulatory oversight even

⁵ There have been some relatively recent exceptions to this low cost and reliable electric power environment, most notably in the 1980s given problematic investment choices by the Washington Public Power System and more recently in the wake of the California power debacle.

though it engages in interstate activities, and it is effectively, if not legally, responsive to the political oversight of the Northwest congressional delegation and is therefore perceived by some to be more accountable to its Northwest customers than are some other entities.

A hydro-based electric power industry has fundamentally different advantages and technical challenges than a thermal-based system⁶. While it generally provides lower cost power, than alternative, primarily thermal-based systems, it remains more vulnerable to uncontrollable external forces such as weather conditions (droughts or floods) and perhaps more highly constrained by environmental issues (e.g. fish, although it does not face air quality constraints), or other economic issues (e.g. maintaining navigable waterways or recreational activities) than thermal systems. There are also greater interdependencies among separate generators, some of which are owned by different power suppliers using the same resource—the Columbia River – for its principal source of electricity generation than exist among independent producers using thermal power. Northwest stakeholders believe these technical differences and challenges with a hydro-based electric power system are critical to understand and must be accounted for in assessing the appropriateness of any “standard market design” economic model for the Northwest region.

Although BPA’s historical dominance of both the electric power generation and transmission services in the Northwest has declined, relatively, over time, it still retains a substantial share of both. BPA staff indicate that its share of total electric power generated in the Northwest areas it serves has declined over the past ten years; but, assuming an average water year, BPA staff expect to supply about 40% of the total electric power provided in its Northwest service area. Because of its size and its federal status, BPA has not only provided transmission services for its customers within its service area but has also been willing to absorb many of the financial risks associated with an energy-limited, and at times variable source of power—hydro power. Historically, BPA has been willing to maintain more stable tariff rates than changes in its short-term costs might otherwise require and it has not established variable or tiered rates to reflect marginal cost changes or maintain profit levels as a private power producer might do⁷. While this behavior has benefited many of its Northwest customers by assuring a relatively stable, low cost supply of electric power, it may have also lulled some of them into an unrealistic expectation that such a managed, economically-protected environment can be continued indefinitely despite significant changes and recent market trends.

CHANGING CONDITIONS AND IMPLICATIONS FOR THE NORTHWEST REGION

Despite the unique elements dominating the Northwest region electric power industry, the region has not been immune to the stresses and turmoil that have confronted other regions as they transform their electric wholesale markets to more competitively based systems. The region experienced two major blackouts in 1996. In July a relay malfunction occurred after a tree tripped a line in Idaho. In August, a series of faults, beginning in the Portland area, created

⁶ For the Northwest region, these differences are magnified by the unique, coordinated, and fully integrated hydro-thermal system developed in the 1960s and 1970s and maintained through a series of contractual agreements

⁷ BPA’s recent financial problems in 2001 and 2002 have resulted in some new tariffs, including some with periodic adjustments, which deviate from this historical practice.

transmission system instability that resulted in loss of service to over 7.5 million customers—mostly outside of the Northwest region. The California electricity market crisis of 2000-2001 spilled over into the region, with some of the effects still being felt. BPA and some other transmission operators have noted an increased incidence of wholesale power curtailments, necessitating greater reliance on redispatching of generation resources. According to BPA staff, the Northwest regional power system in general has been operating with a smaller margin for accommodating emergencies or other surge demands, reflecting the lack of any substantial increase in transmission capacity over the last decade. In addition, BPA itself suffered a series of financial losses starting in FY 2001, resulting in substantial short-term increases in its power rates under a new tariff schedule

While not all stakeholders agree on the risks confronting the region's electric power industry, all stakeholders do agree that some changes would be useful to permit an economically justified expansion in transmission capacity over the long run, to improve operational efficiency, and to increase system security and reliability. Substantial differences remain about how best to accomplish these desired changes, the extent of the changes needed, and how quickly they need to be accomplished.

BENEFITS CLAIMED FOR A UNIFIED, INTEGRATED REGIONAL TRANSMISSION GRID

FERC staff and consultants for regional Independent System Operators (ISOs), RTOs and other electric power market stakeholders have undertaken numerous benefit-cost studies attempting to identify and estimate the relative benefits and costs of establishing an integrated regional electric transmission grid with a single managing entity—an independent ISO or RTO. Such types of analysis frequently rely on economic simulation models that evaluate grid performance in a given area under a range of different operating assumptions. The specific results of such studies are likewise often highly sensitive to the underlying assumptions used and the scenarios tested. The principal claimed benefits from creating an independently operated, integrated electric transmission grid for a region include⁸:

- Improved efficiencies in transmission grid management, resulting from a combination of:
 - Improved transmission pricing through harmonization of tariffs, uniform pricing, elimination of pancaked rates, etc,
 - Better identification and management of congestion,
 - More accurate estimates of available transmission capacity (ATC), thus allowing more complete or intensive utilization of total grid capacity,
 - Grid-wide optimization of scheduling and managing parallel path flows

⁸ These benefits are summarized from the more extensive analysis provided by ICF Consulting, *Economic Assessment of RTO Policy*, Feb. 2002 pps. 6-8

- Lower and less costly reserves, since requirements would be established for the entire grid rather than individual service areas within the grid,
 - More efficient planning for future transmission and generation capacity needs on a comprehensive, grid-wide regional basis.
- Improved grid reliability by
 - Operating the grid over a large region under a common set of procedures and prices,
 - Directing responses to regional transmission system emergencies, curtailments, and system restoration,
 - Coordinating generation and transmission outage schedules for planned events (e.g. maintenance) and unplanned emergencies,
 - Establishing consistent and efficient reliability standards based on comprehensive and objective region-wide reliability studies, and
 - Sharing and coordinating, if not directly providing, ancillary services.
- Reduced opportunities for discriminatory transmission practices, since an independent transmission entity will have no financial interest in other stakeholders' activities and will price and oversee transmission services to maximize overall regional benefits.
- Improved market performance by realizing and distributing operating efficiency gains and providing appropriate incentives for efficient operation of existing and development of new generation capacity.

The Northwest stakeholders have widely disparate and strongly held views on the size and value of these claimed benefits, the likelihood that they will be realized, the costs associated with achieving them, the risks that may accompany them, and the need for another, new, independent regional entity to achieve some of the benefits, especially those expected from consistent operation of an integrated regional transmission grid.

VIABILITY OF STATUS QUO

Most stakeholders have recognized the increased stresses, challenges, and risks confronting the current separate electric transmission grids operating within the Northwest region. Virtually all stakeholders have commented on the lack of any substantial expansion in transmission capacity over the last 10 to 15 years. While there are numerous reasons for this lack of transmission capacity expansion, most stakeholders agree that the inherent uncertainties involved in planning and implementing transmission capacity expansion are exacerbated by the absence of an integrated, region-wide transmission system.

Since 1996, the region has not experienced a severe blackout or other major retail curtailment difficulties similar to incidents in Ohio, the Northeast, and New England. However, the observed increases in temporary transmission schedule curtailments, along with the continued growth in demands for electricity, have increased concerns among many stakeholders about overall system reliability and vulnerability to external shocks. A number of stakeholders realize that the increased utilization of the transmission grid without expansion has reduced the margin of safety available to absorb unexpected external shocks.

Decreased opportunities for access to transmission services for newly developed or planned generation, and the continued existence of underutilized capacity within the system increase electricity costs unnecessarily and are problematic for a growing number of Northwest region stakeholders, albeit not all of them. Continued balkanization of transmission pricing (including rate pancaking across independently operated grids), scheduling, and other ancillary services have been a growing issue for an increasing number of stakeholders. Stakeholders participating in the Regional Representatives Group (RRG) that is developing the Grid West proposal also note that the independently operated transmission grids using different procedures with different and nontransparent operational data have impeded the development of effective tools and procedures for managing congestion. Again, differences remain about the extent of the needed reforms, the immediacy of the need, and the most effective means for achieving those reforms.

THE RTO CONCEPT AND OTHER REFORM ALTERNATIVES

Many Northwest stakeholders agree with FERC's assessment that an independent transmission organization, with no financial interest in any other regional electric industry stakeholder, is the simplest and most direct means of achieving the benefits expected from operating an integrated transmission grid for the region.⁹ A single entity could:

- Develop consistent operating procedures for operating the grid and responding to emergencies,
- Establish common performance data for evaluating grid operations, identifying congestion and other transmission issues and determining appropriate corrective actions,
- Provide efficient regional market clearing and delivery of ancillary services to all users on an equal, consistent basis,
- Create a single tariff for transmission rates that could eliminate rate pancaking, discriminatory pricing, and other pricing issues,
- Monitor the entire regional market to mitigate any remaining market power abuses,

⁹ It should be noted that, while Grid West is designed to be an independent system operator, the fundamental drivers that have shaped the proposal are not based on satisfying the FERC RTO criteria.

- Secure any operational efficiency gains for the benefit of all transmission users,
- Have both a sufficiently broad perspective and relevant performance data to facilitate, if not directly undertake, effective region-wide transmission and generation planning.

Not all stakeholders share this view, however. Some would prefer to see BPA, which still owns about 75% of the region's transmission assets¹⁰, expand its role to encompass region-wide transmission system activities.¹¹ Others¹² believe that existing coordinating mechanisms, such as the Northwest Transmission Assessment Committee (NTAC) and the Pacific Northwest Security Coordinator, could be strengthened and extended, and new ad hoc coordinating entities created, as necessary, to perform those functions that they believe are needed to achieve a more limited set of desired reforms. Yet another alternative is that the major transmission owners, BPA, PacifiCorp, Idaho Power, and perhaps BC Hydro, contract with a single entity to perform for their grids the critical system functions needed to operate and monitor an integrated transmission grid.

One point about each of these alternatives to the Grid West proposal needs to be emphasized. In all cases (except perhaps the BPA-alone alternative), the resulting harmonized transmission tariffs and agreed to operating procedures would still be subject to FERC regulatory oversight. Moreover, each of these alternatives raises its own feasibility, workability, accountability and desirability issues. An assessment of these issues is beyond the scope of this current Academy review.

10 The region here again refers only to the four state area served by BPA – Washington, Oregon, Idaho and Montana. The proposed Grid West footprint is potentially much larger than this. Within the full Northwest Power Pool (NWPP) area, for example, transmission ownership is approximately 1/3 BPA, 1/3 Investor Owned Companies and 1/3 Canadian (BC and Alberta).

11 Note that the footprints of the different alternatives vary. For example, there would be legal barriers to BPA extending its activities into non-Columbia drainage areas and particularly to expanding into Canada. Thus, the “BPA-alone” approach relates to a narrowly defined “region” and not the full NWPP region.

12 The Transmission Issues Group (TIG) has advanced such a proposal. Members of the TIG include

- Grant County Public Utility District (Co-Chair of TIG)
- Portland General Electric (Co-Chair of TIG)
- Avista Corporation
- Douglas County Public Utility District
- Franklin County Public Utility District
- Okanogan County Public Utility District
- Puget Sound Energy
- Snohomish County Public Utility District
- Springfield Utility Board
- Tacoma Power
- Thurston County Public Utility District
- Washington Public Utility Districts Association

THE ROLE OF FERC

FERC is the independent federal agency that is responsible for regulating the interstate transmission of natural gas, oil, and electricity. As such, FERC has jurisdiction over the transmission and sale of wholesale electricity in interstate markets, with the exception of the nonjurisdictional entities: certain cooperatives, publicly owned utilities, and BPA itself. At Congress' direction, FERC is regulating interstate transmission to achieve competitive wholesale markets. Unless explicitly exempted in federal statute, as are the nonjurisdictional entities, entities such as ISOs and RTOs that establish procedures and prices for the transmission of wholesale electric power in interstate commerce will be subject to FERC jurisdiction and regulatory review. However, as FERC itself readily acknowledges, this regulatory role for the transmission of wholesale electricity does not extend either to the regulation of retail electricity markets and sales to consumers or to the location and construction of electric generation, transmission, or distribution facilities.

FERC believes that competitive wholesale transmission markets are best achieved through RTOs as expressed in its Order 2000, issued on December 20, 1999, the FERC White Paper on Wholesale Power Market Platforms issued on April 28, 2003, and a number of other Orders. FERC has continued to emphasize its flexibility in allowing regions to determine the precise form, governance structure, or other characteristics of an RTO. As FERC noted in Order 2000, "industry participants retain flexibility in structuring RTOs that satisfy the minimum characteristics and functions."¹³ In addition to providing flexibility in both the design of the RTO and phased-in timing to perform particular functions, FERC also indicated that it supported "an open architecture policy regarding RTOs, whereby all RTO proposals must allow the RTO and its members the flexibility to improve their organizations in the future in terms of structure, operations, market support and geographic scope to meet market needs."¹⁴ To encourage the formation of RTOs voluntarily, FERC concluded that it would "adopt an open collaborative process that relies on voluntary regional participation to design RTOs that can be tailored to specific needs of each region."¹⁵

Moreover, FERC has gone out of its way to signal its willingness to accommodate the concerns of the Northwest. The 2003 White Paper states¹⁶:

"The Commission is aware that the success of our RTO-based initiative is more likely in a region where the bulk of the transmission grid is in the hands of jurisdictional public utilities. But in the Pacific Northwest, roughly 80 percent of the grid assets are controlled by the Bonneville Power Administration, which is not a public utility under the Federal Power Act. Bonneville's participation in RTO West is essential for RTO West to succeed. Thus, we encourage Bonneville's continued voluntary participation in RTO West.

¹³ FERC, Order 2000, p 6.

¹⁴ Ibid., p 6.

¹⁵ Ibid., p 8.

¹⁶ at pp. 3-4

We are also aware that Bonneville will continue to participate only if RTO West has the flexibility to meet the unique needs of the Pacific Northwest. We clarify what may be obvious. Any decision of Bonneville to meet its obligations and operational responsibilities with respect to such matters as irrigation, flood control, treaties, environmental rules and the like is solely Bonneville's to make and is not jurisdictional to the Commission. While the Commission has limited jurisdiction over Bonneville's rates under the Pacific Northwest Electric Power Planning and Conservation Act, the contracts between Bonneville and its customers do not require Commission review or approval.

We have heard the concerns expressed about the merits of locational pricing and a day ahead market in a region dominated by interdependent hydroelectric resources. With respect to these concerns, our commitment is to work with interested parties, including state commissions, to find solutions that are appropriate to the unique needs of the Pacific Northwest.”

Admittedly, this current FERC regulatory policy could change and become more prescriptive and directive, as was the case in the initial issuance of the Commission’s “standard market design”. However, FERC encountered a forceful negative reaction to that particular proposal not only from its regulated entities but also from the Congress. Consequently, FERC appears to have backed away from the proposal, returning to a more collaborative, flexible, and accommodative approach. The important lesson to be learned here is that, despite its status as an independent regulatory agency, as a practical matter FERC is subject to oversight from both the Administration and Congress and cannot unilaterally impose sweeping regulatory policy changes without broad support in the affected parts of the country.

THE VIEWS OF STAKEHOLDERS

The plan for Grid West includes five general membership classes: (1) Major Transmission Owners, (2) Transmission Dependent Utilities, (3) Independent Power Producers, (4) End-Use Consumers, and (5) State and Provincial Energy Authorities, Tribes, and Certain Public Interest Groups. Subclasses are still being determined for some of these classes. The following summary assessment of stakeholder views reflects staff direct and telephone interviews with a number of representatives from each class, as well as comments received from stakeholder from previous drafts of the report distributed for comment.

Major Transmission Owners

The transmission owners are split. Several of them would seem supportive of Grid West if the proposal contains the potential for the corporation to move beyond the “beginning state.”¹⁷ Others may be supportive, but are primarily interested in the beginning state. Yet others are

¹⁷ In the “beginning state” Grid West would develop a transmission rate tariff schedule and operating procedures for a limited number of functions including a reconfiguration market, a redispatch market, system wide planning and scheduling (including backstop authority for reliability) and a common OASIS. Both the tariff schedule and operating procedures would be submitted to FERC for review, comment, and approval.

supporting the Transmission Issues Group (TIG) effort to look at a non-Grid West alternative. Some transmission owners are exploring control area consolidation. For some transmission owners the costs and risks of Grid West's formation are of concern, but no transmission owner can tolerate an expensive transmission organization that performs poorly. The larger transmission owners are likely to be a coalition for voting purposes while several of the smaller transmission owners may form a bloc to try to counterbalance them on Grid West policy issues.

Transmission Dependent Utilities

The transmission dependent utilities are split. Some are opposed, sometimes strongly, including many large Public Utility District (PUD) generators. Others, including small coops and PUDs in Idaho and Montana, generating coops and small, all-requirements PUDs in Oregon and Washington, are generally supportive. Some transmission dependent utilities appear to be as yet undecided. This group has disparate interests on Grid West policy matters, but the members may seek to vote as a bloc on some governance issues.

Independent Power Producers (IPPs)

The IPPs generally support creating an RTO. They would benefit from simplified scheduling and other procedures, elimination of pancaked rates, "one stop shopping," redispatch to allow for firm deliveries 24x7 notwithstanding constrained paths, flow-based schedules, and system-wide planning for reliability.

The IPPs need access over long time periods so that they can qualify for financing. Under the Grid West proposal, they could have access if they are willing to pay the price of redispatch or run the risk of curtailment. They also want financial rights rather than the current preference system based on physical rights that disadvantages their access. IPPs are likely to act as a single coalition. They support the "free trade" aspects of RTO formation (e.g., "one stop shopping;" single OASIS; consolidation of control areas, etc), but will remain concerned about costs and risks (e.g., who pays for a wrongful order of RTO West that damages IPP property).

End-Use Consumers

Most large consumers, at least in the Northwest region, have opposed formation of an RTO for several reasons. First, there is a belief that the proposal will result in equalization of prices between the Northwest region and California. Second, there is a belief that the benefits are overstated in that Northwest electric power generation seems to be fairly efficiently dispatched. Third, they argue that removing pancaked rates only changes the beneficiary of lower cost resources, but does not result in increased efficiency.

By contrast, small consumers see the benefits of an RTO in removing barriers to trade. Promoting increased efficiency should give the buying utilities (utilities that need more power) more choices of cost-effective resources and give the selling utilities access to more buyers, although generally the net effect should be to benefit buying utilities through lower power prices, all other factors being equal. This group may not have a unified view. Large retail consumers with leverage to negotiate deals in the wholesale market (in states where this is allowed) are

likely to support "free trade" policies. Other commercial users and consumers will be concerned about costs and risks.

State and Provincial Authorities/Tribes/Public Interest Groups

This class is a diverse collection of different interests. Although no formal votes to establish positions have been taken, the Public Utility Commissions (PUCs) appear to be split based on Academy staff discussions and other feedback. PUCs in Oregon, Idaho, Montana, British Columbia, and other PUCs, seem to support the formation of Grid West, particularly the Oregon PUC. The Washington Utilities and Transportation Commission has expressed strong reservations about the Grid West governance structure and, by implication, the need for a new independent entity to manage and monitor an integrated regional transmission grid. The supportive PUCs will support system-wide planning and corresponding backstop authority unless the costs of new transmission facilities impact local consumers in a negative and inequitable manner. The tribal regulatory entities are likely to support tribes' efforts to become resource developers, which they may see as being aided by formation of Grid West. However, given the diversity of this group, the positions of tribes are not easy to predict.

Environmentalists support Grid West's formation because they believe this will facilitate access by renewable sources (e.g., wind power), although they are worried about facilitating access by dirty coal production. The renewable public interest groups support development of Grid West to facilitate the access of renewables on a level playing field. The public interest groups will generally be supportive of "free trade" policies, but cautious about promoting fossil fuels.

KEY GOVERNANCE STRUCTURE CONCERNS

This Northwest context helps define the concerns of various stakeholders and provides a better understanding of the compromises and trade-offs that are reflected in the current Grid West governance structure. Many Northwest region stakeholders fully understand and support the need for the Grid West Board to be independent from any financial interests of other Northwest electric industry stakeholders, but have been equally adamant that the Board be directly accountable to them for their policies, prices, and operations of the integrated transmission grid. A critical issue for Grid West is to build trust among the stakeholders that their concerns will be fully considered in the Board's policy decisions and other actions.

The lack of trust in FERC and the full impact of openly competitive wholesale markets, reinforced by the California energy market debacle of 2000 –2001, led directly to the position that significant future reforms in the Northwest, as specified in the five special issues, should be phased-in and pursued only after stakeholders had an opportunity to review and vote approval for the proposal. Likewise, concerns over the likelihood of realizing expected benefits, the equitable distribution of those benefits, and the impact of a regional transmission entity on the historical advantages of BPA's preference customers, led to the placing of additional restraints on Grid West to minimize cost shifting and preserve long-term contracted services and benefits.

CHAPTER 3: THE PROPOSED GRID WEST GOVERNANCE STRUCTURE

Under FERC's regulatory guidance, many regions of the country have established or are seeking to establish an RTO or ISO to operate an integrated, unified electric transmission grid for the consolidated service area. To be recognized by FERC as an RTO or ISO, the entity must meet FERC's minimum required characteristics and functions identified in FERC Order 2000.¹⁸ The four minimum characteristics of an RTO are (1) independence from power generation and marketing interests, (2) sufficient scope and regional configuration, (3) exclusive operational authority for the electric transmission grid within the region, and (4) responsibility to maintain short-term reliability for grid operations and transmission service within the region. The Order's eight minimum RTO functions are:

1. Tariff Administration and Design
2. Congestion Management
3. Parallel Path Flow
4. OASIS providing information on Total Transmission Capability and Available Transmission Capability
5. Market Monitoring
6. Planning and Expansion
7. Interregional Coordination

However, consistent with FERC's stated policy of flexibility in the design of an RTO to meet specific regional needs, the detailed governance structures and operating procedures differ among the RTOs. At all RTOs, independent governing boards set policy guidance, and oversee and monitor the non-profit corporation that will operate the integrated regional transmission grid. However, the size of these boards, their method of selection, the degree of stakeholder involvement in board activities and policy decisions, and their accountability to regional stakeholders vary significantly.

The currently proposed governance structure for Grid West has evolved, reflecting the Northwest region stakeholders' experiences with Grid West's predecessor RTO-like proposals and their perceptions of the successes or problems that RTOs and ISOs in other parts of the country have encountered. The Grid West governance structure has been defined in an extensive and highly complex set of bylaws for the proposed corporation and developed through a highly collaborative process involving stakeholders in a number of different working groups. However, the Northwest region has also established an extended transition period with a separate set of

¹⁸ FERC has not found, however, that all RTOs or ISOs have in fact met all the required characteristics or minimum functions of Order 2000.

developmental bylaws governing an interim development Board that is created to form the operational non-profit corporation and its Board. The Academy's task is to review the operational bylaws and assess the governance structure of the operational Grid West assuming that it is eventually approved by the stakeholder members.

KEY ELEMENTS AND CONCERNS SHAPING GOVERNANCE STRUCTURE

The current Grid West governance structure, as defined in the operational bylaws, reflects a difficult struggle among Northwest region stakeholders to balance the competing interests of creating a board independent of market participants and subject to FERC jurisdiction, but accountable to the region. The proposed Grid West bylaws contain a number of provisions designed to limit Grid West's ability to act without stakeholder review and approval, but which in some cases also allow the Grid West Board of Trustees to take actions over the objection of its member stakeholders under extraordinary conditions. The proposal includes a number of other safeguards to help ensure that Grid West acts in the interests of the region. These include limited authority to participate in the market, required member approval to move to operational status after an initial period of development¹⁹, stakeholder election and removal of trustees by member representatives, a balanced allocation of voting strength among five member classes, stakeholder voting rights over certain significant policy changes and amendment of the bylaws (subject to a Board override), and rights of transmission owners to withdraw their systems from Grid West operation²⁰, among others. At the same time, Grid West must be able to respond to changing conditions by modifying its policies accordingly, and operate in a manner that provides value to the region in a cost-effective manner.

PURPOSES AND OBJECTIVES OF GRID WEST

Article III of the operational bylaws establishes the purposes for the Grid West nonprofit corporation and also imposes specific limitations. The stated objectives are to:

- Improve reliability and efficient use of the regional transmission grid,
- Provide nondiscriminatory access to transmission services,
- Provide cost-effective regional transmission planning and expansion,
- Support and establish effective monitoring and mitigation of market power abuses and market manipulation

¹⁹ The process for moving from the developmental corporation to an operational one is still under discussion among Northwest region stakeholders. While most stakeholder agree that an operational Grid West will not emerge without a consensus among stakeholders, the process for identifying that consensus is still unresolved and is beyond the scope of this review.

²⁰ While the bylaws address withdrawal rights of most members, the ability of a transmission owner to withdraw from the contractual agreement that permits Grid West to use its transmission facilities and otherwise direct certain transmission operations is expected to be incorporated in the transmission agreements between the owners and Grid West.

- Support effective monitoring of markets, transmission and related services
- Provide sustainable customer benefits.²¹

To accomplish these purposes, the Board is also expected to propose a tariff for transmission and any other authorized services and a set of operating procedures, which would be subject to review and approval by FERC. Unlike most RTOs, Grid West is also limited in taking actions in five specific areas without first securing approval from stakeholder members through a vote of the Members Representative Committee (MRC)²². These five “special issues” involve:

- establishing backstop measures to address chronic, significant commercial transmission congestion problems
- adopting an alternative to the company rate approach for recovering fixed transmission service costs
- creating financial transmission rights for stakeholders
- providing enforcement powers and direct intervention authority for the market monitor
- adopting a loss methodology that overrides individual company loss methodologies

The MRC can prevent the Board from taking action in one of the special issue areas in one of two ways:

- if two-thirds of the MRC opposes (actually 20 negative votes are required even if all 30 MRC members do not vote), or,
- if a simple majority of the MRC opposes and that opposition includes all members of one of the MRC member classes (again 16 negative votes are required among those voting).

However, the Board can override an MRC objection if 7 of the 9 Board members vote to approve action on a special issue.

PROPOSED GOVERNANCE STRUCTURE

Figure 1, below, depicts the proposed governance structure for the operational Board for Grid West. The Board will have nine members who will serve staggered three-year terms. Thus, the initial Board will have three members with a one-year term, three with two-year terms and only three with full three-year terms. Board members must be elected with a supermajority vote from

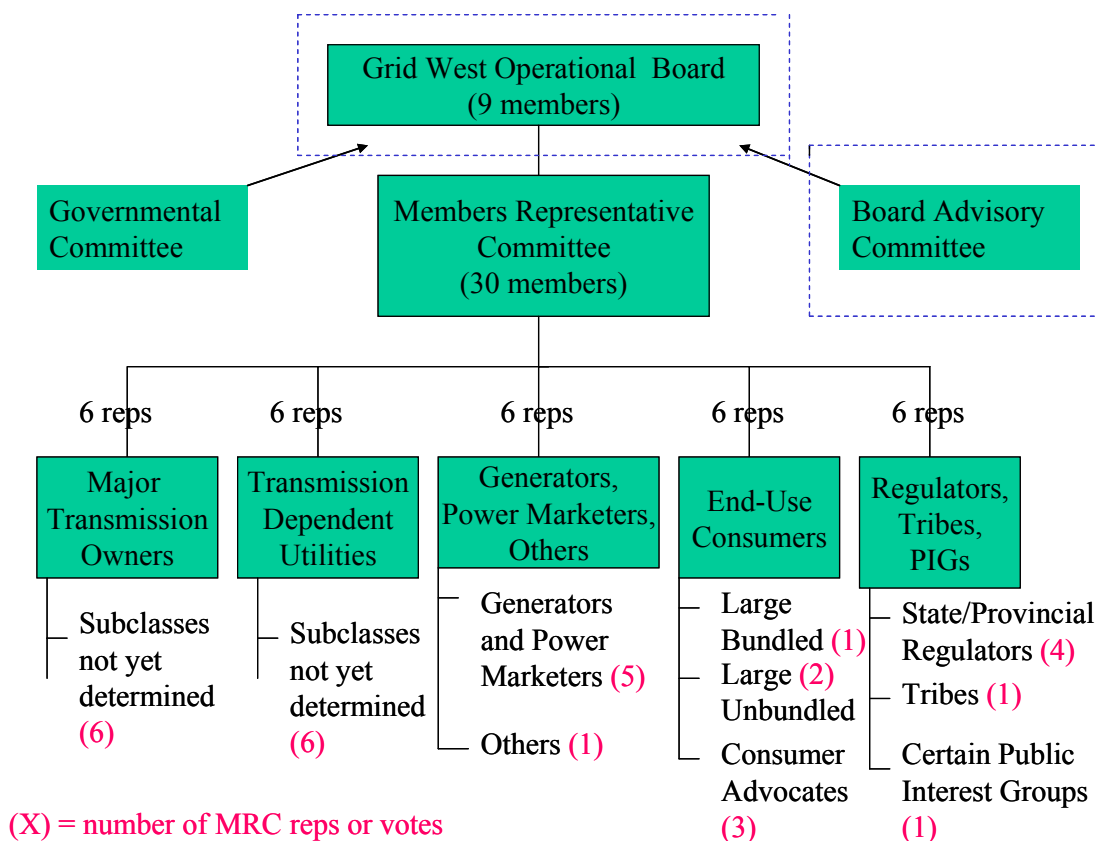
²¹ RRG, *Proposed Operational Bylaws for Grid West*, July 7, 2004 [“Good Enough” version] p 8.

²² The operational bylaws provide for the MRC to disapprove the adoption of one of these special issues, but also provide an opportunity for the Board to override that disapproval if at least 7 of the 9 members agree.

the MRC (24 of 30 votes are needed and there is a complicated procedure for reallocating votes that are not cast to ensure that 30 votes are counted). An executive search firm will be retained to develop a slate of Board members for review and approval by the MRC. The Board, in consultation with the MRC, will direct that firm to establish a candidate slate with a specific number of candidates (the minimum number must be one more than the current vacancies to be filled, but the slate cannot exceed twice the number of vacant positions). In addition, the slate of Board nominees must meet other qualifications including specific knowledge about Northwest region power, or “relevant management experience in commodities markets, utilities law, finance, economics, accounting, information technology, engineering, regulation and public policy.” However, the bylaws do not require that Board members have specific skills, unlike bylaws of some RTOs. Two members of the Developmental Board, if two are willing, must be elected to the initial Operational Board.

The proposed subdivision of the MRC into five representative groups of stakeholders is similar to that found in several operating RTOs and ISOs. What is unique about the Grid West MRC is the 80% supermajority vote required to elect a Board member and the requirement that the MRC approve any Board proposed action in one of the five specified special issue areas (although here only a two-thirds vote, or a unanimous subclass veto with a simple majority objection is required). Stakeholder members are elected to serve one-year terms in their appropriate MRC subgroup, although they can be reelected indefinitely (there are no term limits for MRC members).

Figure 1: Grid West Proposed Structure



PROCESS FOR ESTABLISHING GRID WEST

The current Grid West proposal also establishes an elaborate process, including the formation of a developmental corporation with a five member independent Board and an entirely separate (and similarly extensive and complex) set of bylaws to provide a transitional period to move from the incipient RTO West entity to an operational Grid West organization. The initial step is for the current RTO West Board to adopt the proposed Grid West developmental bylaws and become the Grid West Interim Board. This Interim Board will then reorganize the corporation to form the Developmental Board (five members to be elected by a developmental MRC (same 30-member five-class structure as the operational MRC)). The Developmental Board is intended to develop and negotiate transmission agreements with current transmission owners, develop tariff provisions and operational protocols but it will not offer any services nor will it submit the protocols or tariff proposals to FERC for approval.

The Developmental Board must be elected by the same supermajority vote of the MRC, will be selected by an independent search firm, and will have a term of office for the duration of the Developmental Board. The Developmental Board is expected to promote stakeholder support for the operational organization and will facilitate regional consultation and input by holding monthly meetings with the current RRG and by reaching out to other entities in the region to the maximum extent practicable. The developmental bylaws also contain sunset provisions for the Developmental Corporation if transmission agreements with BPA and two other contiguous transmission owners have not been achieved within a specified period of time.

These developmental bylaws will also specify a mechanism for a phased-in process for adopting the Operational bylaws and creating the Operational Grid West Board. This transition will most likely occur if the members vote to move to the operational stage and if BPA and at least two contiguous IOU transmission owners execute transmission agreements with a 12-month deadline²³.

PROCESS FOR AMENDING GRID WEST OPERATIONAL BYLAWS AND DISSOLVING THE CORPORATION

The Operational Bylaws provide that a vote of one of (1) at least two-thirds of Board members then in office, or (2) one member class of the MRC voting unanimously, or (3) two member classes each voting by a three-fourths margin, is required to propose an amendment to the bylaws. This proposal then must be approved by the MRC through a supermajority vote of four out of the five member classes, each voting by a margin of at least two-thirds of the six votes available to that class.

The corporation may be dissolved if (1) the Board members vote by a two-thirds vote of Board members then in office, and (2) the members ratify the proposed dissolution through a

²³ Again, the details on this transition to an operational Grid West are still under discussion within the RRG and have not yet been fully agreed to. Some parties favor a binding vote while others prefer an advisory vote.

supermajority vote of four out of the five member classes of the MRC, each voting by a margin of at least two-thirds of the six votes available to that class.

The Operational Bylaws expressly provide that if FERC orders a change to the Grid West Articles of Incorporation or the Operational Bylaws and the members do not approve the change according to the provisions of the articles or the bylaws, as the case may be, then the Board of Trustees shall convene a special meeting of the Members to vote on dissolution. The Board shall dissolve the corporation if four out of the five member classes each vote to dissolve the corporation by a margin of at least two-thirds of the six votes available to that class.

CHAPTER 4: ASSESSING THE PROPOSED GRID WEST GOVERNANCE STRUCTURE

To assess the four issues on the proposed governance structure for the operational Grid West entity, the Academy Panel must first assume that the regional stakeholders have not only agreed to adopt the developmental bylaws, but have also decided to adopt the operational bylaws as well. Given these assumptions, the Academy Panel's draft report establishes criteria for evaluating the quality of the Grid West governance structure, assesses key elements of the governance structure, identifies tentative findings, and proposes initial recommendations to strengthen and enhance the workability, accountability, and efficiency of the Grid West governance structure.

ELEMENTS OF A SOUND GOVERNANCE STRUCTURE

Four criteria can be used to judge the governance structure of Grid West and the actual design of the entire organization: (1) capacity, (2) flexibility, (3) accountability, and (4) life cycle.

Capacity

Once the region determines to create Grid West (which is the threshold assumption on which this assessment is based) then the organization must have the capacity to carry out its mission effectively. That means that it must have sufficient resources—in terms of people, systems, and budget—to function effectively.

Perhaps most important from the perspective of this study is whether the governance structure facilitates the ability of the organization to gain and maintain the needed capacity. The governance structure must contribute to the ability of Grid West to carry out its mission. The Board of Trustees must have (1) quality, both individually and collectively, (2) a proper division of responsibilities with the Grid West executive, and (3) adequate authority to carry out its responsibilities.

Flexibility

The governance structure must allow Grid West to act in a timely manner to carry out its functions. There is a time and place for deliberation and a time and place for effective action. Some clear examples exist of the negative experiences of some jurisdictions and the evidence that some stakeholder governance structures ended in deadlocked boards that were unable to make decisions that were urgently needed to deal promptly with major emerging problems in the energy markets.

In assessing the flexibility of the Grid West governance structure, it is important to distinguish between (1) the ability of the Board and executive to carry out the mission of the organization at whatever state it is in between the beginning state and some possible later state, and (2) the limits on flexibility that are imposed by the special issues list and the procedures that are designed to

ensure a broad regional consensus before any of the special issues are approved. The ability of the Board and executive to carry out the Grid West mission and respond to changing circumstances effectively is a governance issue; by contrast, the procedures imposed to approve special issues constitute a political matter that is beyond the scope of this assessment.

Accountability

The issue of accountability involves the questions: accountable to whom? and pursuant to what authority? In the case of Grid West, the operational bylaws attempt to craft a balance between independence from particular energy interests on the one hand and a general responsiveness to the region's energy interests and stakeholders on the other.

Another important issue in the assessment of accountability is the proper regulatory relationship of Grid West to FERC. FERC is the duly constituted federal regulatory authority for transmission of power in interstate commerce and by law plays a regulatory role vis-à-vis Grid West. FERC's authority is both defined and limited by the Federal Power Act. On the other hand, both the courts, notably in the recent court of appeals decision, *California Independent System Operator Corporation v. FERC*, and the Northwest congressional delegation have ensured that there are at least some significant limitations on FERC's ability to impose changes in bylaws or unacceptable governance provisions on Grid West.²⁴ This additional oversight restraint is relevant, notwithstanding FERC's current policy to provide flexibility for regions to design RTOs to meet their specific needs and circumstances, since FERC can change its policies and regulations over time.

Life Cycle

The issue of life cycle can be very important for an organization. Will the governance structure continue to be effective (1) as time passes and (2) if Grid West expands its functions? One critical aspect of the life cycle issue is the extent that an organization can establish its organizational culture and tone in a manner that survives either periods of policy ennui or, conversely, periods when emerging issues require high quality responses. For example, if the governance structure allows for dynamic board members to be punished, either by recall or by failure to be reelected, merely for expressing definitive opinions that lack appeal to a particular group of stakeholders, then subsequent board members are likely to be much more bland and unassertive.

The life cycle is likely to be especially important for Grid West because of the limited nature of the organization in its beginning state. The corporation could expand significantly, either through geographic expansion or perhaps by gaining additional functions that are contemplated under the special issues list. On the other hand, if the organization stagnates, it could suffer possible attrition. The governance structure of the corporation must be capable of addressing those two possibilities and virtually any possibility in between.

²⁴ However, FERC can deny the benefits of RTO status to a non-independent public utility.

THE IMPORTANCE OF LEGITIMACY

The Panel recognizes that opinions of stakeholders in the Northwest region on power issues manifest both intensity and a broad diversity of perspectives. The difficulty of achieving consensus on a regional transmission organization reflects this complex policy environment.

Assuming that Grid West does come into being as an operating entity, it is unlikely that all stakeholders will be satisfied with that outcome. Indeed, some stakeholders have expressed the opinion in interviews that one major purpose of Grid West in the beginning state will be to assuage the concerns of those opposed to Grid West by demonstrating that the organization can operate in a manner that advances the best interests of the region without significantly disadvantaging any particular group of stakeholders.

This complex policy environment requires that both the development and the operation of Grid West be concerned with the issue of legitimacy. Legitimacy means that Grid West functions well in carrying out its mission in the beginning state, that it operates in a cost-effective manner, and that no groups of stakeholders feel that their fundamental interests are ignored.

The development of Grid West reflects this struggle to achieve legitimacy. In contrast to earlier efforts to create a regional transmission organization that some in the region saw as being driven by a remote and insensitive federal government, the Grid West effort is home grown. Many people of differing persuasions have spent much time and care trying to fashion an organization that represents a genuine compromise among the contending interests. The Panel is sensitive to the fact that any recommendations should similarly reflect a balance between its conceptions of an ideal governance model and the need to avoid upsetting a carefully crafted compromise unless there are good reasons to do so.

The organizational bylaws themselves are a product of the effort to achieve legitimacy. If the range of interests and views were less diverse, as is the case in some other parts of the country, for example, the bylaws could have been much shorter and simpler. Instead, the Grid West bylaws are lengthy and often go into great detail to spell out the rights and responsibilities of the various actors and remedies that are available should particular contingencies arise.

Maintaining legitimacy will be an ongoing fundamental concern for Grid West and its governance structure. Even if the organization from time to time may find itself with the authority to carry out an action under its bylaws, because of a bare majority vote, for example, or because stakeholders merely have a consultative role on an issue without power of approval, the Grid West leadership should take care not to be seen as trying to oppress dissenting minorities.²⁵

The converse is also true. Grid West cannot afford to be oppressed by its minorities either. Grid West must be seen as acting consistently in the best interests of the region without being stalemated by its difficult environment. One basic assumption of this study is that—if the region

²⁵ One such example suggested to the Panel was the recent experience of New England Power Pool (NEPOOL) participants. Although only 20 percent of participants voted to accept in its entirety a proposal to establish a New England ISO, that vote was disregarded on grounds that (1) the vote was merely advisory and (2) other votes made clear the will of the participants.

approves the creation of Grid West—then the organization must be free to carry out its mission effectively. Interview respondents who otherwise held differing perspectives tended to agree that the most important task of the Grid West leadership would be to “make sure that it works.”

THE CHOICE OF ORGANIZATIONAL FORM FOR GRID WEST

Some stakeholders have questioned the propriety of delegating a major function such as regional management of aspects of electric power transmission to an independent, nonprofit organization. Some also raise legal issues such as whether the delegation of powers now exercised by BPA would constitute a violation of the United States Constitution or of federal law.

This report is not the place to debate the legal issues.²⁶ However, it is appropriate to note that the delegation of major functions to private organizations has existed since the early days of the Republic. One of the first delegations of authority occurred with the creation of the first Bank of the United States in 1791. In the Nineteenth Century the United States used private instrumentalities for many different purposes, most notably chartering private companies to build the transcontinental railroads and national banks to provide support for the national currency.

Today’s private instrumentalities include a broad range of for-profit, cooperative, and nonprofit organizations that benefit from special access to government benefits and assets.²⁷ In many cases, the use of private instrumentalities means that congressional or state oversight of an activity may become more attenuated than if a governmental body carried out that function.

Grid West is a nonprofit corporation that has been chartered to serve purposes relating to the transmission of electric power in the Northwest. While the federal government or a group of state governments might have authorized one or more governmental bodies to carry out this function, they have not chosen to do so. Creation of a nonprofit corporation to carry out this function is a legitimate choice that the parties in the Northwest are free to make.

That said, the selection of a nonprofit form of organization raises special issues of accountability and governance that need to be addressed. Even independent of legal issues, any proposal to use a nonprofit organization to carry out significant functions should be sure to consider questions of governance and accountability of that nonprofit. That consideration is the subject of this report.

²⁶ For a scholarly review of many of these issues, see, Dan Guttman, “Public Purpose and Private Service: The Twentieth Century Culture of Contracting Out and the Evolving Law of Diffused Sovereignty,” *Administrative Law Review*, vol. 52, No. 3 (Summer 2000), pp. 859-926.

²⁷ See, for example, Thomas H. Stanton, *Moving Toward More Capable Government: A Guide to Organizational Design*, PwC Endowment for the Business of Government, June 2002, available at <http://www.businessofgovernment.org/main/publications/grant_reports/details/index.asp?GID=125>.

AN ASSESSMENT OF KEY ELEMENTS OF THE GOVERNANCE STRUCTURE

This assessment is organized around the four critical governance issues the Academy Panel was asked to address.

Accountability

Has Grid West created a governance structure that is likely to achieve its desired objective of regional accountability? How well have the bylaws balanced board independence from market participants, regional accountability, and FERC jurisdiction?

The Academy Panel was initially concerned by the complexity of the proposed bylaws and governance structure for Grid West. They seemed to be better suited to retard the evolution of a fully functional transmission entity than to facilitate its development. However, information from staff interviews provided an improved understanding of the diversity of stakeholder expectations and apprehensions, which had to be addressed, and the purposes that various bylaws provisions sought to achieve. The Panel fully appreciates the extensive, careful efforts of the Northwest regional stakeholders, through the RRG and other groups, to create a reasonable, workable approach in the Grid West operational bylaws to deal with the complex policy environment of power issues in the Northwest. Nonetheless, the Panel has concerns about the stability of the resulting entity and its ability to make timely decisions on a range of difficult issues it must face even in its beginning state.

Moreover, given recent events in California, the Panel believes it prudent to inquire about the potential for serious harm to the Northwest power system if there were a complete governance failure by Grid West. These concerns were some what allayed by additional information from interviews maintaining that the creation of Grid West and its operation in the beginning state will not result in a weakening of the ability of the major transmission owners, and especially BPA, to intervene in the event of a threat to the power system.²⁸

FINDINGS: The operational bylaws have established accountability to regional interests as a whole while tending to maintain independence of the governance structure from particular special interests and from overly intrusive involvement of FERC.

- A large number of bylaw provisions help to ensure regional accountability. These include:
 - the provision for election of members of the Board of Trustees by a supermajority vote of 24 out of the 30 members of the Member Representative Committee (MRC),

²⁸ Specification of the relationship of BPA and other transmission owners with Grid West will be set forth in transmission operating agreements that were not available at the time of this Panel report.

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- authority of the MRC to remove Trustees either for cause (20 votes required) or without cause (24 votes required),
- the consultation provisions and requirement for a supermajority of the Board to approve the special issues
- requirements for open meetings and access to information
- requirement of a supermajority of the Board before the bylaws may be amended
- authority of members to designate an auditor and require special audits
- requirement that the Board Advisory Committee have opportunity to review the annual budget in advance and comment to the Board
- authority of the MRC to require that management audits be conducted every four years
- authority of the Board Advisory Committee to advise the Board on proposed amendments to tariffs or transmission operating agreements, system planning matters, the annual budget, and proposed measures to implement mitigation of market power or prices
- requirement that, if FERC orders a change to the articles of incorporation or bylaws that the members do not approve, the Board must propose to dissolve the corporation. A vote in which four member classes vote by at least two-thirds of their voting power to dissolve the corporation is binding.
- Many believe that the greatest assurance of regional accountability comes from the region's congressional delegation, which has shown itself to be an active overseer of regional power issues.
 - Both by itself, because of its legal rights vis-à-vis Grid West and its large role in the transmission and generating systems of the Northwest, BPA can be expected to continue to play a key role in power transmission in the Northwest. This would be reinforced by backing from the Northwest delegation, which has repeatedly protected BPA against attempted incursions from authorities, notably FERC and the Secretary of Energy, in Washington, DC.
 - The delegation has shown itself to be an active participant in the process of confining FERC's ability to affect power issues in the region, recently, e.g., in the Standard Market Design proceeding.
 - As an ultimate sanction, the delegation could influence the BPA to withdraw from Grid West, and this would probably end the corporation. The mere availability of the sanction is likely to affect the inclination of FERC to try to impose unwelcome

policies onto Grid West, although the future context of such issues and their outcomes cannot be forecast with any certainty.

- A number of provisions ensure independence of Grid West from particular narrow power interests:
 - The requirement that individual board members (and their spouses, legal partners and dependents) be free of financial interests of any market participant or member;
 - The express statement of purposes and limitations of the corporation in the bylaws; and
 - The election of Board members by the MRC as opposed to being elected directly by the members, as a means of reducing the ability of a Board member to perceive accountability to any particular membership interest.
- On the other hand, while not a governance issue *per se*, the possible withdrawal of BPA, and possibly other major transmission owners, of their facilities from Grid West's management with little advance notice, creates uncertainty and stability issues and could precipitate the dissolution of the corporation. While the inclusion of a provision in the transmission agreements to permit such withdrawal may be necessary to achieve a voluntary organization, it does give these participants greater leverage over the corporation than other members may possess whose withdrawal would not have the same consequences. Consequently, BPA or other large transmission owners will operate as a check on Grid West because they always retain the option to construct and operate their own transmission infrastructure.

PANEL RECOMMENDATIONS:

1. While the bylaws do provide, in Section 7.11, for continuing restrictions on former Board members, the time period for the bar—180 days—seems too short, compared, for example, to the bar on federal employees who leave government service. Therefore, **the Panel recommends that the period be extended to at least a year, and perhaps longer.**

One reason not to extend the period might be for fear of discouraging qualified candidates from becoming Board members Trustees. However, even taking this into account, 180 days seems to be too short a period. If legitimacy is a major continuing issue, then revolving-door employment of Grid West Trustees must be prevented.

2. The bylaws provide, in Section 7.6, for open meetings of the Board of Trustees, subject to some authority to conduct meetings in executive session. The emphasis on open meetings is especially important to ensure the perception of legitimacy of Grid West and its decision-making.

However, the Panel believes that the balance between (1) open decision-making processes and (2) the need for candid exchanges of views on some issues could be strengthened. Thus, **the Panel recommends that the bylaws permit the corporation to hold executive sessions for reasons that would be allowed under the Federal Government in the Sunshine Act (5 U.S.C. Section 552b).**

In particular, the United States Supreme Court, in a unanimous decision in the case of *FCC v. ITT World Communications, Inc.*, 466 U.S. 463 (1984), ruled that the act applied only to deliberations that determine or result in the conduct of official agency business. The court held that an agency could hold non-decisional meetings in executive session as a way of fostering discussion among agency members.

This approach would help to balance the need for effectiveness of the Board, and the fostering of full and frank discussions, against the clear need for transparency as a way of reassuring stakeholders about the legitimacy of Grid West. As with all such issues, sound judgment would be needed by the Board in implementing this approach.

Workability

Has Grid West created an organization that is workable? That is, as a practical matter, taking the proposal as given, will the various limitations, process requirements, and constraints on policy formulation designed to create regional accountability make it difficult for Grid West to succeed as an organization—i.e., to perform its functions at reasonable cost and respond to changing circumstances while remaining accountable to the region?

Given the challenging policy environment in which Grid West will operate and recognizing that many of the difficult decisions it will face will not benefit all stakeholders equally, it is critical for the corporation to obtain a top quality Board and executive who have the motivation, incentives and flexibility to make difficult decisions. The Panel believes that the operational bylaws need to be strengthened in several areas to assure that the corporation can make difficult decisions in a challenging environment. While it is possible that Grid West will be able to obtain a Board and executive of top quality, such quality cannot be assured. That problem, particularly for Board members, is exacerbated when members must stand for election, since some highly qualified candidates may be unwilling to risk a very public rejection or election defeat. This is further compounded when incumbents must stand for reelection after only a three-year term (or, in the case of the founding Board, only one or two year terms for two-thirds of the members). Indeed, increasing numbers of corporations seem to have found themselves lacking appropriate people for their leadership positions. Much will depend on the quality of the people who present themselves for service in the leadership of Grid West, both now and in the future.

FINDINGS: The operational bylaws include a number of features designed to assure a workable organization. However, the difficult policy environment in which Grid West must operate, and the continuing need to assure legitimacy, do constrain the workability of the organization.

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- There are a number of provisions of the bylaws that intend to assure a workable organization:
 - The bylaws require that Grid West use the services of a high quality search firm to seek out good candidates for the Board of Trustees,
 - The bylaws prescribe that the search firm shall consider a number of important criteria in proposing candidates, both individually and as a group,
 - While requiring a supermajority to elect each Board member, the bylaws also preclude the blocking of an election by a small abstaining minority, e.g., by requiring an allocation of votes not cast.
 - While assuring consultation by the Board on virtually all important issues, and assuring continuing influence of the Board Advisory Committee and the MRC (through the possibility of recall and the short terms of Board members), the bylaws permit a supermajority of the board to determine the basic direction of the corporation,
 - The bylaws seem to strike a reasonable balance between the need to compensate Board members well, so as to attract top people, and the need to preserve legitimacy by assuring that compensation is not seen as exorbitant. The same kind of balance will be needed in determining the compensation of the CEO and senior officers of the corporation.
- On the other hand, some provisions of the bylaws do impose limitations on the ability of the organization to act effectively:
 - There is a requirement that no Board member may be removed for cause except by vote of 20 out of the 30 members of the MRC. This creates the possibility that one or more popular but ineffective Board members, who fail to attend meetings, for example, may be retained by Grid West even though this drags down the quality of the corporation's leadership.

The Panel has probed this issue at some depth and does not have a recommendation for an adequate cure. A significant number of interview respondents, representing various points of view, expressed concern that removal of a Board member for cause could be a political act rather than a genuine matter of cause. The corporation should revisit this issue at some point in the future when the distrust of potential outcomes is less acute.

- The requirement that a Board member be elected by a vote of 24 out of 30 on the MRC creates a situation that allows a fairly small minority (20% of the members) to block an otherwise qualified candidate from becoming a Board member. Thus, someone who has expressed an opinion either for or against expanding the role of Grid West in the future might be blocked. Even more serious, Board members who

have had to act decisively to deal with emerging problems may find themselves punished at the next election by a fairly small minority who were offended, even if the Board's actions were in the best interests of the region as a whole.

Given a general concern about obtaining the best available leadership for Grid West, this high threshold for election of Trustees seems excessively burdensome compared to the benefits. As one respondent said, the result could be election of "retired judges," who are demonstrably impartial but not necessarily qualified to serve on the board of a regional transmission organization.

- The Panel expresses no opinion about the procedures required to approve special issues. These are a matter of the scope of the corporation's activities rather than an issue of cumbersome procedures that potentially could impede the ability of the corporation to carry out its responsibilities within the scope of its authorized mission.

Initially, the Panel did have concerns that the special issue that prohibits the market monitor from imposing sanctions to enforce its rules might be a constraint on the ability of Grid West to carry out its mission effectively. However, it now appears that the corporation itself will have the ability to enforce its rules. Such ability will also be helpful in reducing the opportunities for FERC to become involved in such enforcement.

- The supermajority of members that is required to amend the bylaws could pose difficulties in the future. This is because, unlike the special issues list, a large supermajority is required to make any change to the bylaws rather than merely substantial or significant changes. This provision could well impede the ability of the Board to adjust the bylaws to meet emerging needs of the corporation.
 - One example of this concern is the size of the Board of Trustees. While the Grid West Board is not smaller than most RTO boards, it is smaller than the boards of most for-profit and nonprofit corporations. At the moment a nine-member board seems to be a workable number for Grid West. However, if the workload of the board proves too great, a slightly larger board might be useful. Such a change, which would not affect the balance of power among the corporation's stakeholders, could be blocked by a small minority of members of the MRC. There seems to be no good reason for the bylaws to deny the corporation the flexibility to make such changes.
- The Panel also remains concerned about the stability and fragility of a voluntary transmission organization whose members can opt out with little formal notice and no penalty. To be a successful voluntary transmission organization, Grid West must provide tangible benefits to induce members to join and remain as members. Some of these tangible benefits—for example, more efficient use of the regional transmission grid—depend in turn on the provision of timely and reliable information to support effective scheduling of power flows and adjustments to respond to emergencies. Volatile membership and participation in this transmission grid may limit the

effectiveness of any plans for rescheduling or redirecting specific power flows, if members can peremptorily leave. The types of service contracts negotiated by Grid West may alleviate some of these stability concerns, but Grid West may also want to consider some options for a notification period for terminating membership to provide an opportunity to adjust to such changes.

PANEL RECOMMENDATIONS:

1. Given the importance of obtaining a top quality Board, the number of votes required to be elected to the Board of Trustees is an area of acute concern to the Panel. Strong board members must be willing and able to make decisions for the good of the region on the whole even though a small number of stakeholders may not fully share in all the benefits. Therefore, **the Panel recommends that a quorum of the MRC for purposes of voting on election of Board members be changed to two-thirds of the 30 members and that a Board member should be elected on the basis of two-thirds of the votes cast.**

The result of this change would be to allow more otherwise qualified candidates to be elected than would be possible under the current 24-vote requirement. Given the importance of electing quality people, this is an important benefit. Another benefit would be that a small minority could not hold up election of a person merely because the person expressed a view that was not popular with that minority. People who express views on matters of policy relating to the Northwest and its power issues may well have a better background for service on the Board than people who do not hold such views. The impact of this change on matters of controversy, such as whether the Board some day will favor or oppose moving Grid West to another stage, may not be great since a strong majority of votes cast still is required to elect a member. This change may also mitigate another problem in the bylaws. The bylaws have no mechanism to require the election of Board members. Thus a small faction of only seven MRC members could effectively stop Grid West from functioning merely by rejecting all candidates that are proposed for the Board. To avoid this contingency, **the Panel recommends that the bylaws provide some fail-safe provision to protect against such a contingency.**

One possibility is to provide that, if the MRC rejects a specified number of candidates, i.e., fails to give them the requisite number of votes to be elected, then the Board itself shall be authorized to elect Trustees to fill vacant seats. In addition to avoid unnecessary Board vacancies, **the Panel recommends that bylaws provide that Board members shall serve their terms and thereafter until their successors are elected.**

2. Another important issue concerns the staggered terms of Board members. Under the bylaws, members serve a short term of three years. However, to achieve staggered terms, Section 7.1.2 requires that three of the nine Board members initially be elected for one-year terms and another three for two-year terms.

Such very short terms are likely to have a strongly negative impact especially in the early years of Grid West. The early years are a time when the founding Board will need to

establish itself and its organizational culture. That Board will need to select a CEO and senior officers. The early years are not a good time potentially to rotate members off the Board just at a point when they are beginning to understand their jobs.

Therefore, **the Panel recommends that the provisions of the bylaws for a staggered board should only come into effect at the end of the first three years.**

This has the added benefit of allowing the MRC to view the track record of incumbents on the basis of more information than is available after only one or two years of service.

3. Another matter relating to attracting and retaining good people to be Board members concerns the reelection of serving members of the Board. The bylaws do not provide for the automatic renomination of incumbent members when their terms expire. **The Panel recommends that the bylaws permit any two members of the MRC to renominate incumbent members at the end of their terms and that the names of these Board members be added to the list of names submitted by the search firm for consideration by the MRC.**

Two MRC members would be needed to advance an incumbent's name -- one to nominate and the other to second the nomination.

The benefit of this provision is that it allows the MRC to consider the qualifications of incumbents compared to the new nominees proposed by the search firm. Given the supermajority of votes of the MRC that is needed to elect Board members, there does not seem to be a significant disadvantage to this proposal.

Efficiency

Has Grid West included sufficient safeguards and incentives to ensure that it will perform its functions efficiently by keeping its cost reasonably low in light of its mission? Are there other ways to help assure that Grid West will be sensitive to stakeholder concerns that Grid West contain its costs, operate efficiently, improve operations, make timely decisions, and evolve as conditions warrant?

The issue of cost containment is one that was raised by a broad range of stakeholders. They point to the experience of RTOs or ISOs in other parts of the country as evidence of the difficulty of this issue. On the one hand, one does not want to create budget controls that preclude the corporation from carrying out its mission properly. On the other hand, there is a greater need for control over costs than the bylaws thus far have provided. The Panel understands that this issue continues to be under review by the group that is developing the bylaws.

The budget issue is especially salient because of difficulties in making the transition from today's system to a system that includes a regional transmission organization. A common experience in other parts of the country has been that the transmitting utilities do not get rid of the people or the functions that a new RTO is to assume. There is not a deep pool of capable transmission planners or operators. If a new RTO or ISO begins to hire from this shallow pool of talent, and the RTO members do not shed the same function, then they start bidding against each

other for the same talent, and salaries for these people can double and triple very quickly. That was the case in California, and has been true in other areas as well.

If there is not a commitment by the transmitting utilities to turn these functions over to the RTO, the costs will go up as duplication of effort grows. However, those who wish to retain the ability to leave the RTO on relatively short notice are not likely to release their personnel that might be necessary in case of pullout. So the perverse result is that an RTO will almost necessarily be more expensive than necessary, because the transmitting utilities wish to retain their withdrawal options, and that means not letting the RTO do its job without bidding up salaries for both the transmitting utility and the RTO. While the impact of this problem is likely to diminish once an RTO becomes accepted in a region, it is likely to create significant budgetary pressures in the interim that cannot be adequately addressed merely by changes in governance rules.

FINDINGS: The current bylaws provide only, in Section 8.5.3, that the Board Advisory Committee and the Governmental Committee be able to review the corporation's proposed budget at least 90 days in advance of final Board action and provide comments to the Board. This provision is inadequate.

PANEL RECOMMENDATIONS:

To provide for more effective control over the development and monitoring of the Grid West budget, the **Panel recommends that:**

- 1. The bylaws establish a permanent standing Budget Committee of the Board consisting of Board members (perhaps three) and stakeholder representatives (perhaps four) who have a demonstrated knowledge of budget matters;**
- 2. The Budget Committee should be instructed to report its recommended Grid West budget to the Board in a timely manner each year, with a provision for a minority report if a consensus among the committee cannot be reached;²⁹ and,**
- 3. In adopting the annual Grid West budget, the Board would issue a statement explaining any differences between the adopted budget and the budget recommendations of the Board's Budget Committee.**

These budget materials would be included in the corporation's public filings submitted to FERC to explain and justify the basis of its proposed tariff schedule and in the financial portions of its annual report.

²⁹ The current provisions for consultation with the Board Advisory Committee and the Governmental Committee would remain, with the proviso that these bodies would comment on the budget recommendations of the Board's Budget Committee.

The purpose of this recommendation is to ensure that stakeholders with budget expertise have an opportunity not merely to comment on the corporation's proposed budget, but also to help to develop the budget that is considered by the Board. The purpose of publicity is to create a mechanism that requires the Board to justify its actions if it departs from the budget that is proposed by the Budget Committee. Board members can expect that their actions on the budget would be considered when they stand for reelection every three years. It is to be expected that the corporation's executive staff would participate in this process. The staff should be instructed to provide technical support to the Board Budget Committee to assure full consideration of alternative scenarios.

Other Governance Issues

What other comments or observations do you have regarding Grid West governance? What strengths and weaknesses do you see in the current governance proposal given its purpose?

The bylaws attempt to structure rules that ensure that Grid West can remain responsive to the region without losing its ability to act effectively. The paradox, of course, is that the quality of Grid West as an institution will depend on significant factors that the bylaws cannot address in a fundamental way. While poor bylaws can impede effective performance, good bylaws cannot assure a quality institution. The bylaws cannot address critical questions of relationships, notably between the Board of Trustees and the CEO and executive leadership of Grid West. Those are questions of style and interpersonal relations that will depend on individuals and their personalities. Ultimately the quality of Grid West as an institution will depend on the quality of its people and its organizational culture. The founding leadership will play a major role in the success of the organization.

Given the intensity and diversity of opinions about Grid West in the region, the Panel had concerns that a negative policy environment and friction among stakeholders could greatly disadvantage Grid West as a going concern. However, beneath the diverse perspectives and interests, the Panel's research has uncovered an impressive ability of different stakeholders to work with one another for the common good of the region. There has been a tradition of collaborative efforts in the Northwest on power issues that often transcends disagreements among particular interests. The operational bylaws themselves reflect a substantial effort by people with different points of view to reach constructive accommodation. This track record of constructive mutual effort, more than any particular provision of the bylaws, bodes well for the ability of Grid West to function effectively. The process for approving the transition to the operational stage will be important in giving Grid West the legitimacy that it needs to build on this constructive base.

FINDINGS: From the perspective of governance, a critical issue is the relationship of the Board to the CEO and executive. On the one hand, the Board must provide sound oversight of the CEO; on the other hand, it must refrain from micromanagement and involvement in management issues that are properly the province of the CEO. This relationship cannot be specified in bylaws.

Another critical issue involves compensation of the CEO and senior officers. The Board will need to strike a balance between (1) the amount that an informed executive search firm believes to be appropriate compensation for a demanding position with a quasi-public institution such as Grid West, and (2) the need to maintain legitimacy in a region where the head of BPA is paid much less than he or she can command in the private sector for a similar position. Again, this cannot be addressed in the bylaws. The bylaws do set the amount of compensation of Board members, and this will need to be revisited from time to time to ensure that the appropriate balance is maintained.

Also a number of respondents in interviews discussed the need for solid technical input from stakeholders to the Grid West Board and staff. The Board Advisory Committee might create technical subcommittees to meet this need, but this is probably not a suitable matter for an actual bylaw provision. Perhaps more important, the Board must be sure to actively solicit views from the Board Advisory Committee and probably from other groups of stakeholders as well. As the bylaws themselves recognize, outreach and consultation are important responsibilities of the Board. The Board should experiment with a variety of mechanisms to obtain input from stakeholders on virtually all major issues.

Finally, brief discussion is merited concerning the fiduciary responsibilities of Board members and officers of the corporation. These people should represent neither the interests of particular stakeholders nor the conceptions of particular ideological points of view. Instead, their responsibility is to represent the best interests of the corporation, within its mission as defined by law and in the bylaws. It would be important that all performance evaluations of Grid West Board members, officers, and employees should keep this issue in prominent focus. Transmission of power is such a critical matter for the region that, once Grid West becomes a going concern, the focus of Trustees, officers, and employees needs to be on the ability of the corporation to carry out its difficult mission.

PANEL RECOMMENDATIONS:

Because the bylaws cannot anticipate future changes, govern critical interpersonal relationships, or control management styles that affect corporate performance, the **Panel recommends that:**

the bylaws should provide for creating a Governance Committee of the Board of Trustees to deal with Board performance and on-going as well as unanticipated, future Grid West governance issues.

The purpose of the committee would be to keep abreast of sound governance practices and to assist the Board to review its performance annually. This Governance Committee also would review the performance of the CEO and senior officers of the corporation annually.

An annual Board appraisal, conducted under the auspices of the Governance Committee, can produce a number of benefits, in terms of improved Board performance, better team dynamics

and communications, greater clarity with regard to Board members' roles and responsibilities, and improved CEO-Board relations.³⁰

The bylaws, at Sections 7.12.6 and 9.13, provide that the Board shall adopt conduct rules for Trustees and employees, respectively. This code should spell out important issues of role and responsibility, such as the fiduciary responsibility of Board members to act with competence and diligence and in the best interests of the corporation, as well as ethical issues such as limitations on the revolving door and prohibitions on self-dealing.³¹

While the bylaws necessarily contain fairly general statements, in Section 7.12.1, the Code of Conduct would be much more specific and also would incorporate legal requirements from the Washington State laws under which the corporation has been chartered. Therefore, the **Panel recommends that:**

the bylaws be drafted in such a way as to permit the corporation to adopt more stringent conduct requirements, e.g., as to limitations on subsequent employment, than are included in bylaw provisions.³²

This flexibility is especially important because of the difficulty of amending the bylaws. A strong Code of Conduct is an integral part of the corporation's need to retain legitimacy in the eyes of the region.

CONCLUSION

These Panel recommendations are intended to improve the workability, flexibility and responsiveness of the proposed Governance Structure of Grid West. As the Panel has noted several times, the currently proposed bylaws and governance structure are exceedingly complex and excessively detailed. The Panel has understood and accepted, to a large degree, the reasons for that complexity. However, the Panel would encourage the Grid West members to consider in the future amendments to simplify and streamline that structure, should Grid West prove to be successful. Such future bylaws revisions should also seek to assure that provisions that could frustrate the achievement of the potential benefits of Grid West are eliminated or modified.

30 A good description of this process is found in Jay A. Conger, Edward E. Lawler III, and David L. Finegold, *Corporate Boards: New Strategies for Adding Value at the Top*, (San Francisco: Jossey-Bass, Inc., 2001), Chapter Seven. See also, Berit M. Lakey, Sandra R. Hughes, and Outi Flynn, *Governance Committee*, (Washington, DC: BoardSource, 2004). Most for-profit and nonprofit governance committees are responsible also for nominating board members. That is not appropriate for Grid West because the bylaws assign the nominating function to the MRC rather than to the Board.

31 These issues are addressed in the Code of Conduct that has been issued under the Developmental Bylaws.

32 For example, the express examples of the last sentence of Section 9.13 potentially could be read to preclude the Board from imposing complete revolving door restrictions on employees who leave the corporation to ensure that they do not work for any stakeholder for a specified period of time. The bylaws might be clarified to assure that such a negative inference cannot be drawn.

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We are submitting this draft Panel report to stakeholders and other interested people and organizations for review and comment. The Panel would like to take this opportunity to thank the many people who submitted comments on the initial staff draft report and who have contributed their time and insights to assisting the Panel in its work.